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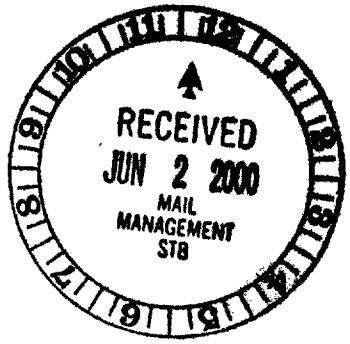


Honorable Vernon Williams
Secretary
Surface Transportation Board
1925 K Street NW
Washington, D.C. 20423-0001

Re: Ex Parte 582 (Sub-No.1), Major Rail Consolidation Procedures

Dear Mr. Williams:

Enclosed for filing in the captioned proceeding are the Reply Comments of the Ports of Seattle, Tacoma, and Everett, Washington. There is an unstapled original and twenty-five copies. I have also enclosed a disk with this cover letter and the Reply Comments in WordPerfect 9 format.

I have served copies of this letter and the Reply Comments on all parties to the proceeding by United States First Class mail addressed to the counsel listed on the service lists published by the Board.

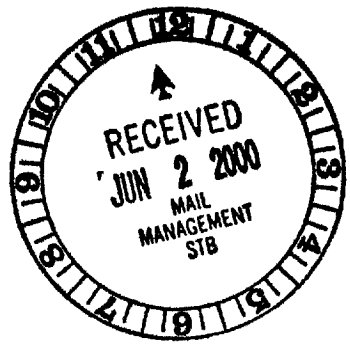
Yours very truly,

John Broadley

John Broadley

Enclosure
cc: w/enclosure
Service List

BEFORE THE
SURFACE TRANSPORTATION BOARD
Washington, D.C.



MAJOR RAIL CONSOLIDATION PROCEDURES	)	Ex Parte No. 582 (Sub-No. 1)

REPLY COMMENTS OF THE PORTS OF SEATTLE, TACOMA AND EVERETT, WASHINGTON

The Port of Seattle, the Port of Tacoma and the Port of Everett (collectively the "Ports") submit these reply comments to clarify their position in light of the comments filed by other parties, and also to address certain points made in the opening comments of other parties. We will begin by clarifying our position on the four issues we addressed, and then will address certain other issues that have been raised by other commenters.

CLARIFICATION OF THE POSITION OF THE PORTS

1. Local Access.

A review of the comments filed in this proceeding leaves little doubt that there is a broad consensus in support of conditioning future Class I mergers on the merging carriers opening up their terminal areas to reasonably priced switching. Some commenters favor describing the switching obligation in terms of "terminal areas" while others favor use of some more concrete measure such as the 30 kilometer rule used in Canada. Precisely how such conditions should be shaped likely will have to await specific merger proceedings. The Ports believe, however, that the Board's guidelines should make clear that local access conditions will be imposed expansively with the object of providing competitive options to as many shippers located on the merging carriers as is feasible. Moreover, the Ports believe that the guidelines should make clear that the Board will not be constrained by narrow definitions of "terminal" as that definition may have been used in other sections of the Interstate Commerce Act.

There is a general recognition that to provide meaningful relief, the switching charges must be reasonable. There is also a perception that many switching charges currently in place are unreasonably high. On the other hand, the Ports strongly believe that the switching charges must be fully compensatory of the costs incurred by the switching carrier, including the cost of capital employed in the facilities used for switching. As we outlined in our opening comments, the Ports

are critically dependent upon a healthy and competitive rail system connecting the Puget Sound area to the rest of the country. The price of local access should not be set in a manner that discourages investment in local access facilities. The Ports recommend that the Board undertake a separate proceeding to determine an appropriate methodology for establishing compensatory switching rates that can be applied on a nationwide or a regional basis.

The Ports are aware that the imposition of Local Access as a merger condition may result in an unbalanced situation with shippers on merging carriers having switching access to other carriers, but shippers on non-merging carriers in the same market remaining captive. This unbalanced access may have the effect of discouraging mergers that have significant public benefits. Accordingly, the Ports recommend that the Board give consideration to using its power under 49 U.S.C. 11102 to require non-merging Class I carriers to provide reciprocal switching access, at least in those markets where they will be substantial beneficiaries of switching access to shippers on the merging carriers.

2. Long-Haul Access.

The Ports appear to have been the only commenters to address the issue of Long-Haul Access. The Long-Haul Access issue is a central concern for the Ports. Historically, the traffic lane between the Puget Sound area and the Twin Cities and Chicago was served by several competing railroads. As recently as 1969 this traffic lane was served by the Great Northern Railway and the Northern Pacific Railway (using their jointly owned Spokane, Portland & Seattle Railroad) and by the Chicago, Milwaukee, St. Paul & Pacific Railway. The Union Pacific's route from Portland, OR to Omaha and via the Chicago Northwestern could also provide service to Chicago over trackage rights between Portland and the Puget Sound area.

Despite the fact that the Great Northern and the Northern Pacific were strong railroads, the Commission allowed them to merge over the objections of the Department of Justice, a decision that ultimately was affirmed by the Supreme Court. *See Great Northern Pacific -- Merger -- Great Northern,* 331 I.C.C. 228 (1967); *United States v. I.C.C.*, 396 U.S. 491 (1970). The Commission based its decision to approve the Northern Lines merger on the cost savings of the merger and on the competition that a strengthened Milwaukee would provide to the merged company stating with respect to the Milwaukee (*Great Northern Pacific -- Merger -- Great Northern,* 331 I.C.C. 228, 276):

> Opening of the 11 gateways, and in particular Portland, makes it evident we believe, that Milwaukee will become a viable transcontinental rail competitor.

In affirming the Commission's decision, the Supreme Court similarly noted the conditions the Great Northern and Northern Pacific had accepted to protect the Milwaukee and extend its competitive reach and concluded (*United States v. I.C.C.*, 396 U.S. 491, 516):

> All this will enable the Milwaukee to compete with the Northern Lines for east-west traffic and some north-south traffic as well as linkage with Canadian carriers to the north, which was previously the exclusive domain of one or both of the Northerns. Other conditions of lesser consequence will buttress the newly designed competitive posture of the Milwaukee.

The Northern Lines merger was consummated and the Burlington Northern was formed. The Puget Sound - Twin Cities - Chicago traffic lane was reduced from three carriers to two, plus the Union Pacific.[1]

The optimism of the Commission and the Supreme Court about the vigor of the Milwaukee Road proved unfounded. That company ran into serious financial difficulties shortly after the consummation of the Northern Lines merger and sought inclusion in the Northern Lines merger under the terms of a Commission imposed condition. The Commission rejected the Milwaukee's inclusion petition, *Great Northern Pacific -- Merger -- Great Northern*, 348 I.C.C. 821 (1967) on the grounds that the Milwaukee was to be the *competitor* to the Burlington Northern, and its inclusion would frustrate that purpose. The Milwaukee shortly thereafter entered bankruptcy proceedings and was liquidated with pieces of its western lines being acquired by Burlington Northern. *See Burlington Northern -- Acquisition -- Chicago, Milwaukee*, 363 I.C.C. 298 (1980).

With the liquidation of the Milwaukee Road, the Puget Sound - Twin Cities - Chicago corridor was reduced from two rail carriers to one, the Burlington Northern, plus the Union Pacific's service to Chicago through Portland.[2]

The Ports are concerned that the Union Pacific is not a fully competitive player in the intermodal market between the Puget Sound area and Chicago. Traffic in that lane is dominated by BNSF, and, indeed, UP provides no service to the Port of Everett. The Ports are not certain what factors contribute to UP's relative impotence as a competitor. Its access into the Puget Sound area is via trackage rights on BNSF from Portland. The UP routing through Portland is more circuitous than the BNSF routings. If a significant part of the UP's lack of competition in this major traffic lane is the result of UP's physical access and routing, it is a problem that needs to be addressed in the final round of rail mergers.[3]

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[1] Neither the Commission nor the Supreme Court appeared to consider the Union Pacific as providing significant competition in the Puget Sound to Chicago market.

[2] The Union Pacific acquired substantial Milwaukee facilities in the Puget Sound area which enhanced its ability to serve the area.

[3] The Ports' perception is that this issue is a limited one, affecting only a small number of major market areas in the United States. Thus, a remedy mandated by revised merger guidelines will not have a broad impact on the structure of the nation's rail industry.

3. Implementation.

A great number of comments addressed the implementation problem. The general thrust of the comments is that there must be more plans filed with the Board -- now an "Implementation Plan" explaining how the merger will be implemented.[4] The Ports do not contest the need for an operating plan, nor do they contest the need for an implementation plan, what they do question is the need for imposing an additional requirement for the applicants to file plans with the Board. As a practical matter, plans "filed" with the Board are drafted by (or under the influence of) lawyers with the objective of satisfying the Board's procedural requirements. The problem with past mergers has not been one of satisfying the Board's procedural requirements -- the applicants' lawyers rarely fail on that score -- but one of making the merger work. The nub of the problem is with the merging carriers' real operating plans and real implementation plans, not with their filings with the Board.[5]

The issue the Board must address is how to ensure that the merging carriers' real plans are subjected to a continuing critical analysis by experts. The Ports believe that the way to do this is to use independent experts. In the Ports' original comments, we recommended that the operating plan the applicants file with the Board pursuant to 49 CFR Part 1180 be subject to audit by an independent consultant. In light of the other comments filed, and on further reflection, the Ports believe that the role of the independent consultant should be further expanded to include a separate opinion on the plans the merging carriers have made for implementing the merger.[6]

4. International.

By and large the comments filed were consistent with the position taken by the Ports.

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[4] Some commenters have suggested that major mergers be implemented in stages, with the Board being required to approve each stage before the merging carriers can proceed to the next stage. The Ports believe this is a highly undesirable approach. Rail mergers are complex and it is doubtful that they are readily subject to this type of segmentation.

[5] The Ports are not suggesting that applicants are less than candid with the Board when they file their operating plans, simply that plans evolve over time and the Board's procedural and substantive filing requirements may not mesh well with what is needed in practice.

[6] The Ports are not certain how to deal with the problem of the evolution of the operating plan over time. Between the date on which the operating and implementing plans are filed with the Board and the date of consummation of the merger, there will have been many changes in circumstances and in the way the merging carriers plan to operate and implement the merger. One option which may make sense is to condition the consummation of the merger on the independent consultant rendering a supplementary opinion on the final plans immediately before consummation -- perhaps the operating and implementing equivalent of a "bring-down" letter.

RESPONSE TO OTHER POSITIONS[7]

1. Competition is not a radical idea.

The principal objection to the approach taken by the Ports is that it is a "radical" one. We beg to differ. Competition is not a radical idea in the US economy -- it is the "rule of the road." Indeed, competition is not a radical idea in the railroad industry -- a great deal of rail traffic is subject to strong rail to rail, rail to truck and other forms of competition. In assessing the propriety of the Ports' recommendations, we need to keep clearly in mind what railroad want when they come to the Board seeking merger approval.

Congress has conferred on the Board the power to grant the railroads exemptions from the "rule of the road" if it finds such exemptions to be in the public interest. The burden, however, is clearly on the proponent of an exemption to justify it. Congress has not granted the railroad industry a *presumptive* exemption from the "rule of the road," but one that requires a prior affirmative demonstration that it is in the public interest.

In the past, the Ports have been supportive of the efforts of the railroads to eliminate excess capacity and to make their operations more efficient. They have acquiesced to a reduction in rail-to-rail competition as part of the price of enhanced efficiencies which have occurred. The era of contraction is almost over, however, and the core issue of the future is how to enhance the responsiveness of the railroads to the changing needs of shippers. The Ports believe that for the long term the answer to that question is merger conditions that will decisively move the national rail structure to one that is inherently more competitive. When circumstances change (as they will) and a shipper's relationship with its railroad must be renegotiated, the most useful thing the shipper can take to those negotiations is a competitor railroad's telephone number, not a set of Board-imposed merger conditions that may or may not address the issues and may or may not motivate the railroad to address them.

2. Competition will not bankrupt the railroads.

It is argued that enhanced competition will either bankrupt the railroads or deprive them of capital needed for investment. There is a short answer to this argument with respect to the level of competition the Ports are proposing. Where it has been tried, it has not bankrupted the railroads. The merger conditions that the Ports are proposing, even if imposed generally across the US rail industry and not limited to the merging carriers, would, at best, bring rail-to-rail competition

[7] The Ports here are responding not only to comments that have been filed but also to objections that they have become aware of informally. The Ports expect to see those objections expressed in other reply comments.

in the United States to the level existing in Canada today.[8] There is no evidence whatsoever that the Canadian rail industry is going bankrupt as a result of the competitive circumstances it faces. To the contrary, a comparison of the operating margins of the Class I carriers suggests that exposure to competition at the Canadian level has, if anything, a positive effect on performance:[9]

Railroad	1998 Margin	1999 Margin	2000 Margin[10]
CN	32.5%	37.2%	39.0%
BN	33.4%	34.4%	35.5%
UP	14.4%	25.6%	29.5%
NS	35.3%	23.0%	24.5%
CSX	17.8%	15.6%	18.5%

3. This is not re-regulation.

The Ports are *not* proposing re-regulation of the railroad industry. It has been contended that the imposition of pro-competitive conditions of the type the Ports are proposing would "re-regulate" the railroad industry. Nothing could be further from the truth. In order to deal with this contention, however, it is appropriate to recall again what the railroads seek from the Board -- exemption from the antitrust laws.

Railroads are subject to the same antitrust laws as almost every other industry in the economy.[11] When two railroads come to the Board seeking approval of a merger, they are asking to be exempted from application of the antitrust laws that apply to almost every other

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[8] The Ports' proposed merger guidelines would not permit the type of one-railroad monopoly at a US port that now exists at the Port of Halifax. On the other hand, the Ports have *not* proposed to condition future US mergers on acceptance of a regime such as the competitive line rates provisions of the Canada Transportation Act, *see* Canada Transportation Act, Sections 129-136, or on the adoption of rate dispute resolution procedures such as the final offer arbitration provisions of the Act. *See* Canada Transportation Act, Sections 159-169.

[9] Canadian Pacific is not included in this comparison because the railway forms a relatively small part of Canadian Pacific Limited's overall operations. The operating margin data for CP Limited would not necessarily reflect the performance of the railway.

[10] Operating margins are taken from Value Line reports on the railroads, March 17, 2000. Operating margins for 2000 are Value Line estimates.

[11] There are some limits on the *remedies* an antitrust court can grant to private plaintiffs, *see* e.g. 15 U.S.C. 26; *Keogh v. Chicago Northwestern Railway Co.*, 260 U.S. 156 (1922); and *Square D v. Niagara Frontier Tariff Bureau*, 476 U.S. 409 (1986), all of which are in place to protect the jurisdiction of the Board.

business. To contend that the Board's imposition of some limitation or conditions on that exemption from the antitrust laws constitutes "re-regulation" makes turns the language on its head. The merging railroads are seeking and receiving antitrust immunity for their merger, a privilege generally not available to other industries in the economy under any terms or conditions, but an immunity that is more circumscribed than they would like. This is neither "regulation" nor "re-regulation."[12]

[12] Indeed, when the Justice Department applied the antitrust laws to the merger of the Great Northern Railway and Northern Pacific Railway they *prohibited* the merger. *See Northern Securities Co. v. United States*, 193 U.S. 197 (1904).

CONCLUSION

As the Ports stated in their opening comments, the next round of mergers will be the Board's last clear chance under current law to shape a rail industry structure that will serve the public interest. The merger guidelines the Board adopts in this proceeding will foreshadow the shape of that rail industry structure for many years to come. The Ports strongly recommend that the Board adopt supplementary merger guidelines that condition approval of (and antitrust immunity for) mergers of Class I railroads on the merging carriers taking substantial steps toward a more competitive rail system; specifically on:

(i) the merging carriers providing Local Access to all shippers on their lines and on connecting short lines as outlined in the Ports' comments;

(ii) the merging carriers providing Long-Haul Competition to all major market areas they serve as outlined in the Ports' comments;

(iii) the merging carriers submitting an analysis and certification by an independent consultant of their post-merger operating plan as outlined in the Ports' comments.

Respectfully submitted,

THE PORT OF SEATTLE

By: M.R. Dinsmore
Its Executive Director

THE PORT OF TACOMA

By: Andrea Riniker
Its Executive Director

THE PORT OF EVERETT

By: John M. Mohr
Its Executive Director

Dated: June 2, 2000